Global Equity Views

Themes and implications from the *Global Equity Investors Quarterly*

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In brief

- After a strong year for global equities, our investors think that most markets offer reasonable but not outstanding opportunities; they suggest a typical level of allocation to equities. Few see this as a great time to invest aggressively but most expect reasonable returns over the next couple of years.
- Profits remain healthy and are rising in most regions. However, momentum is slowing and some of our investors think that expectations for more margin expansion in 2025 look optimistic. Meanwhile valuations are high in the all-important U.S. market and in India, but much more moderate elsewhere.
- Our preferences are unchanged; many of our investors favor adding to more defensive stocks, higher quality names and value. The artificial intelligence (AI) debate rages on, with more skeptics than optimists on our team, at least over the near term.

Taking stock

Since our last update in July, our estimates of global profits growth have slipped slightly, led by weakness in energy (declining oil prices) and Europe (softer economy). But overall, we see steady growth ahead, with the U.S. leading. In our research, 2025 continues to look strong for profits. We expect 12% profit growth globally, once again led by the U.S. and selected emerging markets. Below the surface we see that earnings growth is expected to broaden out across the U.S. market, but at the same time forecasts for some of the most cyclical sectors (autos, materials and energy) have fallen sharply in recent weeks.

It's a complicated picture, with multiple mini cycles playing out at different times across the market. For example, the home improvement retailers are in the third year of declining profits, a prolonged hangover from the pandemic boom that looks close to ending. Meanwhile the auto industry is a recent source of weakness both in the U.S. and international markets. Even within industries we see sharp divergences between haves and have-nots. Semiconductors are a good example, with AI spending booming but industrial/automobile demand persistently weak. Company-level analysis and stock selection remain key to making the right decisions.

Meanwhile, trends within markets have been quite divergent between regions. Enthusiasm for the fastest growing businesses did cool a little in Q3 across the U.S. and European markets, and lower priced, dividend paying stocks outperformed. This of course barely dents the long run trend of growth stock dominance over the last year and the last decade. In our valuation work, mid cap and small cap stocks are priced at unusually wide discounts almost everywhere. The spread between growth and value stocks remains wide, especially in the U.S. market.

With profits growing and valuations for most markets close to long-term averages, our investors expect reasonable returns. As in our last quarterly update, our choices are somewhat conservative; defensives, value and high quality are all more popular themes. AI-driven names with high valuations and the expensive Indian market are high on the list of areas of caution for our portfolio management team.

Will market returns broaden out? Reading the latest evidence

After a remarkable period of highly concentrated returns within the U.S. market, seemingly everyone is asking when the less fashionable 493 stocks in the S&P 500 Composite will find favor. Here's the latest evidence as we read it.

We find two main reasons to expect a broadening of returns. First, in our work, the gap in earnings growth between mega cap technology and the rest is narrowing and will continue to narrow into next year. In our view the so-called "Magnificent 7," (the leading technology companies) will outgrow the remaining 493 companies in the S&P 500 by around 30% this year, but that gap should narrow to 13% in 2025 and continue to fade over the longer term (**Exhibit 1**). Second, the biggest stocks trade at near record premium valuations; the size factor has rarely looked more relatively expensive in our work.

The biggest argument against a market broadening has been that the trend of profits revisions for the big technology winners has been consistently strong for many years, giving growth investors few reasons to change course. Strong revenue growth and massive free cash flow generation is a very powerful combination and has been the winning formula for two decades. Meanwhile the performance of the rest of the market has been far more pedestrian.

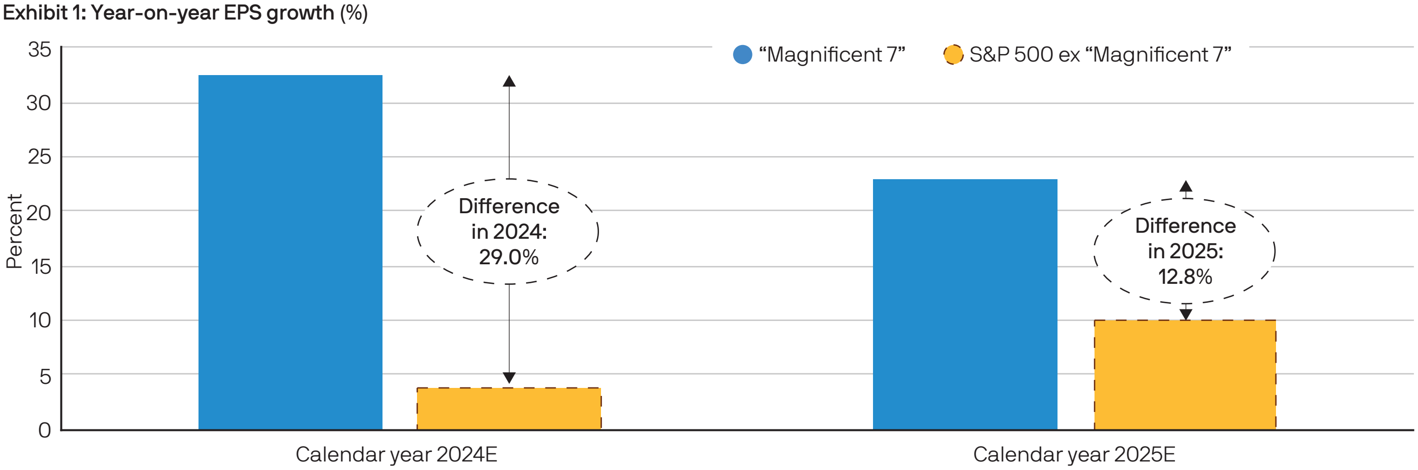
As always, stock selection opportunities remain for us the most important issue to focus on. The so-called Magnificent 7, or for that matter the other 493 companies in the S&P 500 benchmark, are not single units to allocate to or away from, but individual companies presenting very different opportunities. This perspective will drive our investment strategies. Most of our managers do have plenty of exposure to Amazon, Nvidia, Microsoft and Meta, but take more cautious views on Tesla and Apple. Right or wrong, those stock selection decisions will drive our results.

China: A stimulus-sparked rally and signs of improving shareholder returns

The most dramatic move in global markets this year has come from China. The government's surprising package of stimulus measures, designed to revive the economy, sparked a 30% rally in a single week and a violent rotation within the Chinese equity market. In markets outside China, the news led to gains in beaten-down names with exposure to the Chinese economy.

The gap in earnings growth between the Magnificent 7 and the rest of the S&P 500 will continue to narrow

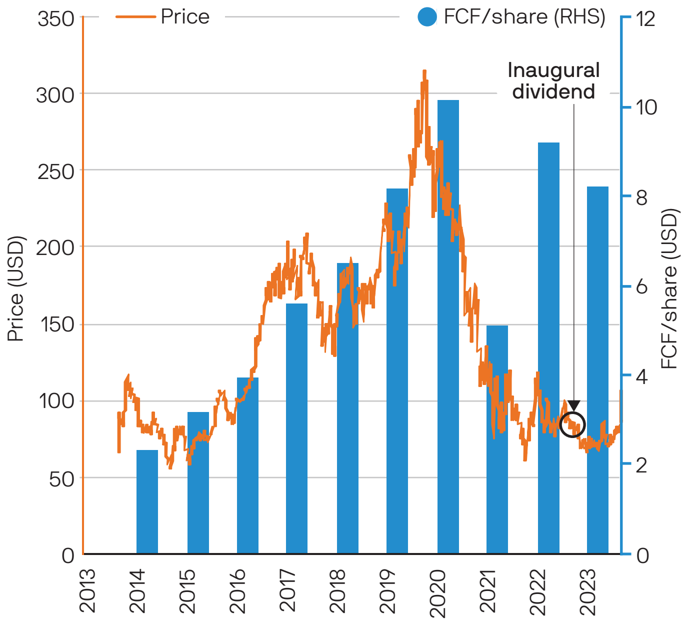
Exhibit 1: Year-on-year EPS growth (%)



Source: J.P. Morgan Asset Management earnings estimates; data as of September 30, 2024.

There are signs of more focus on shareholder returns by Chinese companies

Exhibit 2: Alibaba—FCF versus price



Source: Chart LHS: Spectrum, Harmonic weighted average Price to Book; chart RHS: Bloomberg, Alibaba Price return vs FCF per share; data as of October 1, 2024.

Of course, the actual impact of these new measures will take time to assess, but our China team thinks that the message is that the government is determined to do what it takes to prevent a further deterioration in the economy and financial markets.

After these moves, the valuation of the Chinese market is well above depressed levels, but there is still plenty of upside potential as well should local investors come back to the market in force. Compared with local bonds, stocks still look very low priced indeed.

China's economic outlook does still look very difficult to our investors, and corporate earnings remain both weak and unpredictable. We do however take some encouragement from signs that the bigger, more profitable companies are starting to pay a little more attention to shareholders, with dividends and even buybacks gaining in popularity. Alibaba, JD.com and Moutai have all acted recently to introduce or improve dividends and buy back (**Exhibit 2**). It is too early to call this a clear trend, but perhaps less economic growth along with more capital discipline will deliver better shareholder returns.

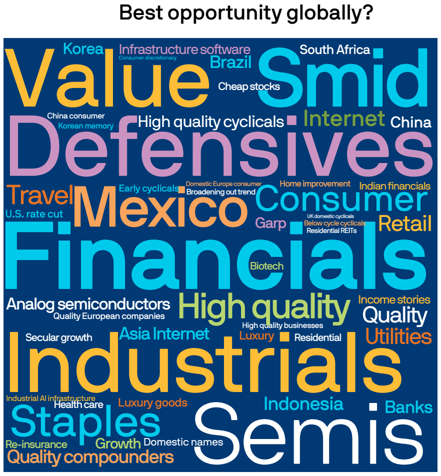
Our emerging market portfolios mostly remain slightly underweight China, and focused on higher quality stocks that do have the ability to pay better shareholder returns. As always, we have more faith in our ability to analyze company-level fundamentals than predict the swings in sentiment at the macro level.

Exhibit 3 shows the views of our team members. Many favor defensive and higher quality names while remaining skeptical about AI enthusiasm.

Views from our *Global Equity Investors Quarterly,* October 2024

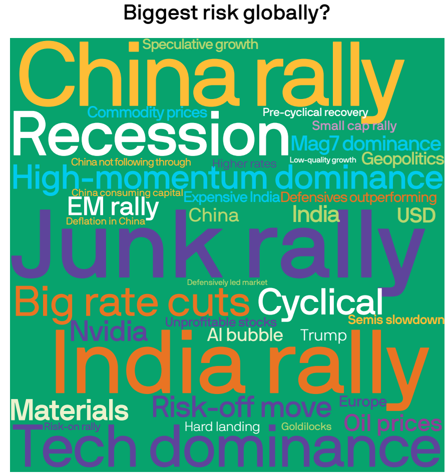
Exhibit 3

Best opportunity globally?



Worst opportunity globally?

Biggest risk globally?



A subset of survey results are shown for Global Equity Investors Quarterly participants taken in October 2024. These responses are taken from a quarterly survey representing 53 CIOs and portfolio managers across Global Equities.

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